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BEFORE THE ARIZONA CORPORATION C



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COMMISSIONERS

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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS PARADISE
VALLEY WATER DISTRICT

DOCKET NO. W-01303A-05-0405

Arizona Corporation Commission

DOCKETED

JUN 13 2008

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IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
COMPANY, INC., AN ARIZONA
CORPORATION,
FOR APPROVAL OF AN AGREEMENT
WITH THE PARADISE VALLEY COUNTRY
CLUB

DOCKET NO. W-01303A-05-0910

**CLOSING BRIEF OF THE COMMISSION
STAFF**

I. INTRODUCTION.

Arizona American Water Company ("Company") applied for and the Arizona Corporation Commission ("Commission") approved an increase in rates for its Paradise Valley Water District in Decision No. 68858 (July 28, 2006). Due to concerns expressed by the Town of Paradise Valley ("the Town") and others regarding the significant rate increase to high usage customers under the two surcharges which were to be used to fund fire flow investment, the Commission ultimately agreed to re-look at the rate design issue. More specifically, the Commission moved to revisit the issue in the context of an alternative Rate Design Agreement ("RDA") signed by the Town, the Sanctuary on Camelback Mountain, the Camelback Inn, the Scottsdale Renaissance (collectively the "Resorts"), the Camelback Estates Homeowners Association, the Clear Water Hills Improvement Association and Finisterre Homeowners Association (collectively the "Homeowners Associations").¹ Resort witness Thorton stated that the RDA is a memorialization of the consensus between Homeowners' Association representatives, the Town of Paradise Valley, and the three major commercial

¹ Tr. 50:11-15.

1 consumers.² While Arizona-American was not a signatory to the Agreement, it does endorse its
2 adoption with some changes.

3 The Town and Resorts were granted intervention in the Docket at a procedural conference
4 held on March 10, 2008. Parties prefiled testimony and an evidentiary hearing was held on May 15
5 and 16, 2008.

6 The Commission Utilities Division Staff ("Staff") evaluated the RDA that was submitted by
7 the Town and Resorts. Staff recommended that if the Commission desired to address the concerns of
8 the Town, Resorts and Homeowners Associations, as well as higher use customers, the Commission
9 should approve those portions of the RDA that would ameliorate the impact of the surcharges at this
10 time, until they could be the subject of further examination in the Company's next rate proceeding.
11 This would result in a reduction of the High Block Usage Surcharge and elimination of the Public
12 Safety Surcharge, at this time. Adoption of Staff's position would result in deferral of consideration
13 of all other aspects of the RDA including the ACRM-like mechanism that would fund future fire flow
14 improvements and the reclassification of funds collected pursuant to the surcharges.

15 Based on testimony provided by the Company's witness Mr. Thomas Broderick at the
16 evidentiary hearing on May 15, 2008, however, it appears that at least from the Company's
17 perspective although it was not a signatory to the RDA, that the major components of the RDA are
18 nonseverable. The position of the RDA signatories on this issue was not clear, however. If indeed
19 the various components of the RDA are nonseverable, Staff's position is that the entire RDA should
20 be denied. Otherwise, Staff recommends adoption only of the RDA's proposed reduction of the High
21 Block Usage Surcharge and elimination of the Public Safety Surcharge.

22 **II. ARGUMENT.**

23 As part of Decision No. 68858, the Commission approved the use of two surcharges to
24 provide sufficient funds to construct fire flow improvements desired by the Town. The High Block
25 Usage Surcharge was set at \$2.15 per thousand gallons. The Public Safety Surcharge was set at
26 \$1.00. The Town and Resorts subsequently expressed concern regarding the unanticipated increase
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² Tr. at 240:21-25.

1 in water utility bills due to the combined impact of the two surcharges.³ Following additional
2 discussions between the Town, Resorts, and the Company, the RDA was developed and filed by the
3 Town on January 16, 2008.

4 The salient points of the RDA are that it would reduce the current High Block Usage
5 Surcharge from \$2.15 to \$1.00 per thousand gallons of usage, and would continue to account for the
6 proceeds as contributions in aid of construction, and provide for recovery of all unrecovered fire flow
7 costs incurred through February 29, 2008. In addition, the RDA would reset the Public Safety
8 Surcharge from \$1.00 per thousand gallons to \$0. The Public Safety Surcharge would be
9 reconfigured to operate like an arsenic cost recovery mechanism ("ACRM").⁴ Under the RDA, the
10 Commission would use the fair value finding in Decision No. 68858 to determine the fair value of
11 later step increases and the surcharge would continue to apply only to the commodity portion of the
12 rate.⁵ In contrast to the High Block Surcharge, however, the Public Safety Surcharge would recover
13 investments made after March 1, 2008 using a revenue requirements formula rather than accounting
14 for the funds as contributions.⁶

15 According to the Town's witness Councilwoman Mary Hamway, the purpose of the RDA was
16 to respond to unintended consequences of the High Block Usage and Public Safety Surcharges.
17 Essentially, the Town's concern is that the Resorts, which are an integral source for the Town's tax
18 revenue, are placed at a competitive disadvantage since a substantial portion of the funding for the
19 surcharges is obtained from the Resorts.⁷ Further, the Town expressed a concern regarding
20 inadequate notice to residential ratepayers whose usage would subject them to the surcharges as
21 well.⁸ Finally, the Town indicated apprehension over the water conservation implications of the High
22 Block Usage surcharge on residential ratepayers.⁹ The Town is also concerned that the current
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25 ³³ Counsel for the Resorts indicated that the combined impact of the surcharges resulted in an increase in the Sanctuary's
rates by 234%; an increase in the Camelback Inn's rates by 221% and an increase in the Renaissance's rates by 191%.
Tr. 51:15-18.

26 ⁴ Ex. S-1 at 5.

27 ⁵ *Id.*

28 ⁶ *Id.*

⁷ Ex. T-2 at 5.

⁸ *Id.* at 6.

⁹ *Id.*

1 surcharges require only a small percentage of customers to pay for the fire flow infrastructure while
2 all residents of the Town benefit from that infrastructure.

3 Based on Staff's evaluation of the RDA, portions of the Agreement would provide some
4 interim rate relief to the Resorts and residential users who are affected by the surcharges. Staff
5 therefore recommended that if it is the Commission's intent to provide interim rate relief, that Staff
6 could support certain elements of the RDA. Staff recommended adoption of the reduction of the
7 High Block Usage Surcharge to \$1.00 per thousand gallons as proposed in the RDA as well as
8 resetting the Public Safety Surcharge to \$0.¹⁰

9 However, Staff opposed making a determination that would alter the treatment of funding of
10 fire flow improvements after March 1, 2008, as something other than contributions. As Staff witness
11 Darron Carlson testified, it is inappropriate to entertain these types of alterations to the prior Decision
12 at this time.¹¹ Rather, this is a significant change in accounting for the funds received which should
13 be thoroughly vetted in the Company's next rate case.

14 Likewise, Staff opposed approval of the RDA's proposed drastic change to the Public Safety
15 Surcharge which would convert it to an ACRM-like mechanism at this time. As Mr. Carlson stated:

16 Nothing should be predetermined in this proceeding to limit or preempt
17 the Commission's rate options in the next rate case. A future rate
18 proceeding that allows for a comprehensive and full consideration of all
19 options is the appropriate vehicle for deciding any possible alternate
20 rate treatment of the high block surcharge collections.¹²

21 As Mr. Carlson further explained during the evidentiary proceeding, "[v]ery seldom is more analysis
22 not beneficial."¹³ According to Mr. Carlson, Staff opposes taking such a significant deviation from
23 what was approved in Decision No. 68858 outside of a full rate case because the magnitude of the
24 changes cannot be properly evaluated within the context of a proceeding of such narrow and limited
25 scope as the present one. "[E]verything about the [rate] design was created for the contribution [in

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27 ¹⁰ Ex. S-1 at 8-9.

28 ¹¹ Ex. S-1 at 10.

¹² *Id.* at 9-10.

¹³ Tr. at 332:5-6.

1 aid of construction] aspect. If you want to change that, we need to reanalyze the entire aspect, and
2 it's not involved in this limited proceeding."¹⁴

3 The Company countered that adopting only individual components of the RDA as Staff
4 proposes would jeopardize present construction of the fire flow project. Mr. Broderick stated, "only
5 the ACRM-like step increase and the re-set High Block Surcharge ("HBS") provide the
6 contemporaneous funding sources for Phases 3 and 4 of the [Fire Flow Improvement Project]."¹⁵ In
7 response to Staff's position on the RDA, the Company has already chosen to suspend construction of
8 Phase 3B of the fire flow project and onwards.¹⁶ Mr. Broderick testified during the evidentiary
9 proceeding that the Company is still receiving funds earmarked for construction of the fire flow
10 improvements.¹⁷ In response to the Staff's position, the Company contends that, "the key
11 components [of the RDA] were immediate interim rate relief and continued construction of fire flow
12 projects, if not acceleration of a timetable."¹⁸ As such, the Company argues that the RDA cannot be
13 split. "And the glue that made that work was the ability to have the conversion of the public safety
14 surcharge from a contributions mechanism to a revenue requirements mechanism."¹⁹

15 While the actual signatories to the RDA stated that they support the RDA, their position on
16 implementing the rate reduction portions of the RDA now and deferring the remainder of the RDA's
17 provisions to the rate case was not clear.

18 Overall, Staff finds the position of the Company to be without merit. The Company has
19 provided no basis in its testimony for the proposition that the goal of immediate rate relief cannot be
20 obtained absent the adoption of radically different infrastructure funding proposals.

21 The linkage of contemporaneous funding to a present capacity to build the fire flow
22 improvements is not borne out by the Company's actions. The Company presently is receiving funds
23 specifically approved for the purpose of constructing fire flow improvements.²⁰ However,
24 construction has ceased based on unilateral decisions made on the Company's part in response to

25 ¹⁴ Tr. at 325: 9-12.

26 ¹⁵ Ex. A-2 at 3.

27 ¹⁶ *Id.*

28 ¹⁷ *See, Tr.* at 104:16-20; 124:2-6, 125:6-12.

¹⁸ Tr. at 103:18-21.

¹⁹ Tr. at 103:22-25.

²⁰ Tr. at 104:16-20, 124:2-6, 125:6-2.

1 Staff's position on the RDA.²¹ The Company claims that suspension was not inappropriate because
2 its construction costs exceed the funding received to-date. It is also clearly the Company's
3 contention that it is not under specific obligation pursuant to a Commission order to continue
4 construction of the fire flow project under any and all circumstances.²² The alternative that the
5 Company could fund future construction itself appears to give rise to Company fears that the
6 Company's finances will be at risk of later rate recovery.

7 The notion that adoption of Staff's position could result in harm to the Company is not
8 compelling. As Mr. Carlson explained in the following colloquy, the Company is in no jeopardy of
9 any harm even if the components are adopted separately.

10 ALJ Wolfe: Do you think that granting the part of the request in the RDA that Staff
11 is recommending be granted is harmful to the company?

12 Carlson: No, I do not believe so. Again, the reason the company has already
13 stated they've already stopped construction, so there is no harm at this
14 stage. It means absolutely nothing to them, because all of the money
from the surcharges is contribution. It doesn't affect their revenue, and
it doesn't affect their bottom line at all.²³

15 What's more, the Commission has already approved the inclusion of approximately \$3 million from
16 prior construction of fire flow improvements in rate base in the Decision.²⁴ As such, it is readily
17 apparent that adoption of the Staff's recommendation for only partial adoption of the RDA does not
18 place the Company at any undue risk.

19 Testimony during the hearing also supports deferral of the proposed change in accounting
20 treatment and future structure of the surcharges to the Company's next rate case. First, it was clear
21 during the hearing, that various portions of the Agreement were ambiguous and subject to varying
22 interpretations. Second, the signatories to the Agreement comprise only a small part of the
23 Company's customer base. Decisions as to how the surcharges should function or be accounted for
24 in the future should be made with the type of broader based input likely in the Company's next rate
25 case. Finally, testimony at the hearing indicated that the Commission had recently rejected a similar
26 ACRM like mechanism proposed by the Company in its recent Sun City Water District rate case.

27 ²¹ Ex. A-2 at 3.

28 ²² Tr. 123-126.

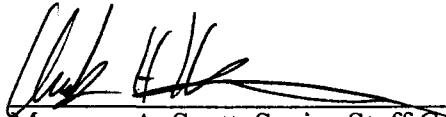
²³ Tr. 334:12-20.

²⁴ Decision No. 68858 at 12:14-15. *See also* Tr. at 106:25-107:9.

1 **III. CONCLUSION.**

2 For the above stated reasons, Staff recommends two alternatives depending on whether the
3 RDA's subcomponents are severable. If they are severable, Staff recommends approval of the
4 reduction of the High Block Usage and elimination of the Public Safety Surcharges. If they cannot
5 be separated, then Staff recommends rejection of the entire RDA.

6 RESPECTFULLY SUBMITTED this 13th day of June 2008.

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